

Private foundations; self-dealing, sale to disqualified person. The sale to a disqualified person of stock by a private foundation owned by it continuously since May 26, 1969, but not constituting excess business holdings on that date, is excepted under section 53.4941(d)-4(b)(1) of the regulations from the prohibition against self-dealing under section 4941 of the Code.

#### ISSUE

Under the circumstances described below, would the sale to a disqualified person of stock owned by a private foundation continuously since May 26, 1969, but not constituting excess business holdings on that date, be excepted under section 53.4941(d)-4(b)(1) of the Foundation and Similar Excise Tax Regulations from the prohibition against self-dealing under section 4941 of the Internal Revenue Code?

#### FACTS

The foundation is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation within the meaning of section 509(a). Since May 26, 1969, the foundation and its disqualified persons, within the meaning of section 4946(a), have at all times owned 100% of the outstanding stock of M, a profit-making corporation. During this period of time, the number of shares of M stock actually owned by the foundation and the percentage interest of M represented by such shares have remained unchanged. M has been engaged primarily in the business of leasing real property to N, also a profit-making corporation, since May 26, 1969.

N is also a disqualified person with respect to the foundation.

In each of its taxable years prior to 1985, 95 percent or more of M's income consisted of rents from real property as described in section 512(b)(3) of the Code, and during such years M was excepted from classification as a 'business enterprise' by reason of section 4943(d)(3)(B) of the Code. In 1985, less than 95 percent of M's gross income was derived from real property rentals. The remainder of M's gross income was derived from the leasing of tangible personal property, consisting of commercial and industrial equipment, to unrelated third parties.

Accordingly, in 1985, M was no longer excluded from classification as a business enterprise for purposes of section 4943 of the Code. Therefore, the foundation's stock ownership in M became an excess business holding subject to tax under section 4943. In order not to be liable for such tax, the foundation proposes to sell all its stock to N for an amount equal to its fair market value in a transaction that will not constitute a prohibited transaction within the meaning of section 503(b).

## LAW AND ANALYSIS

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(A) of the Code defines the term 'self-dealing' to include any direct or indirect sale or exchange of property between a private foundation and a disqualified person.

Section 4943(a)(1) of the Code provides for a tax on the excess business holdings of a private foundation equal to 5 percent of the value of such holdings.

Section 4943(c)(1) of the Code provides that the term 'excess business holdings' means the amount of stock or other interest in a business enterprise that the foundation would have to dispose of to a person other than a disqualified person for its remaining holdings to be 'permitted holdings.'

Section 4943(d)(3) of the Code provides that the term 'business enterprise' does not include a trade or business at least 95 percent of the gross income of which is derived from 'passive sources.' Gross income from passive sources includes items excluded by section 512(b)(3).

Section 512(b)(3) of the Code excludes from the definition of the term 'unrelated business taxable income' rents from real property. Section 512(b)(3) does not exclude rents from personal property unless leased with and incidental to real property such that less than 50 percent of the total rent is attributable to the personal property.

Section 101(1)(2)(B) of the Tax Reform Act of 1969, P.L. 91-172, 1969-3 C.B. 35, and section 53.4941(d)-4(b)(1) of the regulations provide that section 4941 of the code shall not apply to the sale, exchange, or other disposition of property owned by a private foundation on May 26, 1969, to a disqualified person if the private foundation is required to dispose of such property in order not to be liable for the excess business holdings tax under section 4943 and if the private foundation receives in return an amount which equals or exceeds the fair market value of the property in a transaction that is not a prohibited transaction within the meaning of section 503(b).

Section 53.4941(d)-4(b)(1) of the regulations provides that the determination of whether a private foundation is required to dispose of property in order not to be liable for tax under section 4943 of the Code is to be made without regard to section 4943(c)(2)(C) (relating to the 2 percent de minimis rule) and as if every disposition by the foundation were made to a disqualified person.

But for the exception of section 101(1)(2)(B) of the Tax

Reform Act of 1969 and section 53.4941(d)-4(b)(1) of the regulations, a sale by the foundation to N would constitute self-dealing within the meaning of section 4941(d)(1)(A) of the Code since it would be a direct sale of property by a private foundation to a disqualified person.

The foundation's stock in M is clearly property owned by a private foundation on May 26, 1969. Such stock has been owned by the foundation at all times since May 26, 1969, and will be owned until its proposed sale to N. Moreover, the proposed disposition is being made in order to avoid liability for tax under section 4943, and the foundation is receiving in return an amount that is not less than the fair market value of the M stock being sold to N. Thus, the basic requirements for application of section 101(1)(2)(B) of the Tax Reform Act and sections 53.4941(d)-4(b)(1) of the regulations appear to be present.

Under these circumstances, the issue is whether, for purposes of the exception to self-dealing provided by section 101(1)(2)(B) of the Tax Reform Act of 1969 and section 101(1)(2)(B) of the Tax Reform Act of 1969 and section 53.4941(d)-4(b)(1) of the regulations, the stock owned by the foundation on May 26, 1969, must have been in an entity that, as of such date, constituted a 'business enterprise' within the meaning of section 4943(d)(3) of the Code. Sections 101(1)(2)(B) and 53.4941(d)-4(b)(1) do not specifically require that the property owned by a private foundation on May 26, 1969, must have been a holding in a 'business enterprise: on that date. These provisions only require that the 'property' being disposed of must have been held by a private foundation on May 26, 1969, and must be sold or otherwise disposed of in order not to be liable for tax under section 4943.

Therefore, in this case, the proposed sale of stock by the foundation to N, is disqualified person, would be excepted from the provisions of section 4941 of the Code and the disqualified person would not be subject to the self-dealing tax imposed by section 4941.

Since the holdings of the private foundation and its disqualified persons are aggregated in determining the private foundation's excess business holdings position, if any portion of the holdings is sold to its disqualified persons, it would remain in an excess business holdings positions for purposes of section 53.4941(d)-4(b)(1) of the regulations until the last scintilla of such holdings is sold. Therefore, the entire holdings of the private foundation in M are treated as excess business holdings and may be disposed of under the exception to self-dealing under section 4941 of the Code provided under section 53.4041(d)-4(b)(1). See also Rev. Rul. 75-15, 1975-1 C.B. 359.

HOLDING

Under the circumstances described above, the sale to a disqualified person of stock owned by a private foundation

continuously since May 26, 1969, but not constituting an interest in a business enterprise as of such date, is excepted under section 53.4941(d)-4(b)(1) of the regulations from the prohibition against self-dealing under section 4941 of the Code, if the disposition is made in order to avoid the presence of excess business holdings under section 4943.